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SUBJECT: ARGENTINA: ARGENTINA: LES WAGE LEVELS CONTINUE TO ERODE AS INFLATION PERSISTS

REF: BUENOS AIRES 160

¶1. (U) This document is sensitive but unclassified. It should not be disseminated outside of USG channels or in any public forum without the written concurrence of the originator. It should not be posted on the internet.

Summary

¶2. (SBU) With the Argentine economy slowing rapidly and most local analysts predicting a 2-3 percentage point contraction in 2009, expectations have been that inflation levels would also decelerate significantly. While "true" inflation is off its mid-2008 annualized peak of roughly 25%, it has remained stubbornly high and there are few signs of further decline in the near future. Although official GoA statistics show year-on-year inflation in the range of 6%, private analysts say it is about three times that level: in the range of 15-20%. Public and private salaries have been increasing at a similar rate, with the GoA recently announcing a 15% public sector wage increase. As a result, Argentina is likely looking at several years of stagflation, with the cost of living facing Argentines and Embassy personnel staying high. As a result, despite four salary increases in the past twelve months, Embassy Buenos Aires locally engaged staff (LES) salaries continue to lag behind local comparable salary levels. End Summary.

Rapid Economic Deterioration Fails to Dampen Inflation

¶3. (SBU) The cost of living in Argentina continues to rise, despite the general consensus among economists and financial analysts in late 2008 that inflationary pressures would subside in response to the sharp deceleration of domestic economic activity, tighter monetary policy, and higher interest rates. Reflecting this shared belief, late last year analysts forecast that 2009 inflation would be at the lower end of the 15-20% range, and many of Post's contacts were predicting inflation would even fall into the 10-15% y-o-y range by the end of 2009.

¶4. (SBU) There are certainly forces at play that are slowing the rate of inflation, which has fallen from a peak mid-2008 level of 25% y-o-y. Real growth, which averaged 8.5% per year between 2003 and 2008, has fallen off a cliff in 2009, with most economists estimating a recession in 2009 of about 2-3%, as well as much lower capacity utilization and a major

contraction in domestic demand. Central Bank monetary policies have also been increasingly contractionary in recent years, contributing to higher local interest rates (still negative in real terms, albeit less negative than in previous years). Financial uncertainty over the last year, which led to huge increases in yields on all Argentine government debt issuances and provoked major capital outflows (\$23 billion in 2008 and almost \$6 billion in the first quarter of 2009), also pushed up local interest rates and brought bank lending almost to a halt. Finally, lower commodity prices and the government's elimination of many subsidies on utilities and transportation have reduced fiscal spending and curtailed consumption of such goods.

¶15. (SBU) The combined result is that many factors that pushed unsustainably high growth in domestic consumption and led to the overheating of the Argentine economy in recent years have diminished in importance in 2009. Nevertheless, the relatively high private sector estimates for inflation so far in 2009 have brought into question the accepted wisdom that inflation will subside significantly in the future. In fact, many analysts are now reporting that they see no signs that true inflation levels will continue to fall further from current levels.

Contrary to Official Stats, CPI Continues to Climb

¶16. (SBU) Consumer prices, as reported by Argentina's national statistics agency, INDEC, rose by a much lower than expected 0.3% month-over-month rate in April, down from 0.6% m-o-m in March. The y-o-y official headline inflation figure improved

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to 5.7% in April from 6.3% in March. Year to date INDEC reports that consumer prices have risen by only 1.9%.

¶17. (SBU) However, as Post has reported on numerous occasions (reftel), virtually all private sector economists and analysts take as a given that INDEC is manipulating inflation statistics. (This, in turn, distorts and understates measures of unemployment and poverty levels. There are also strong suspicions that INDEC manipulation has now extended to the national accounts). Actual or "true" y-o-y inflation, estimated by numerous independent private sector analysts, is instead in the range of 15%-20%, or nearly three times higher than the officially reported figures.

¶18. (SBU) Goldman Sachs reports a "consensus estimate" for actual or "true" inflation in April exceeding 1% m-o-m. Noted local consulting group Evaluadora Latinoamericana, which is one of the few private organizations to conduct its own consumer price survey, estimates May inflation at 15.6% y-o-y. Another well-known firm, Fundacion Mediterranea, uses San Luis Province's data on price changes, since San Luis is one of the more independent provincial governments. For April, San Luis reported 15.5% y-o-y. Other noted Argentine economists have higher estimates, including Miguel Kiguel, who argues that inflation is stuck at around 17% with minimal chance of falling significantly further this year.

CPI Expectations Refuse to Budge

¶19. (SBU) In tandem with high CPI readings, consumer inflation expectations have come down significantly from their peak mid-2008 levels (of about 30%), but remain stubbornly high. The median of Di Tella University's 12-month inflation expectations index, remains unchanged at 20% since March.

Wage Hikes Continue

¶10. (SBU) According to a recent survey by SEL Consultores, a think tank specializing in labor issues, despite the slowing economy, companies still expect unions to demand wage increases of about 20% (on average), in line with 2009 inflation estimates. The GoA set the stage with its recent announcement of a 15% two-stage public sector wage increase for 2009. The Banking Association has agreed to 19% wage increases, the construction industry has agreed to 15% increases, and many other sectors of the economy have reported wage increases in the same range or higher. These increases are lower than those of previous years. For example, INDEC reports that salaries rose by an average of 22.4% in 2008, and increased an average 50% for the combined period 2007-2008.

Embassy Salaries Still Lagging Behind

¶11. (SBU) In spite of Post and the Department's best efforts -- four salary increases over the last year) Embassy salary levels continue to lag the market. The gap is further exacerbated by the recent wave of GoA and private sector wage increases in the range of 15-20%. In sharp contrast to the 50% 2007-2008 average wage increase in the country, Post implemented a 5-6% wage increase in 2007 and a 13% wage increase in 2008. To place this in a longer-term context, INDEC reports that from December 2001 - December 2008, salaries increased on average 189%, compared to the Embassy average accumulated increase of only 71%.

¶12. (SBU) Depressed Embassy salaries are negatively affecting recruitment and retention, as demonstrated by several recent lost opportunities to hire qualified personnel for key positions. For example, the well-qualified candidate we selected for our Security Assistant position was considering leaving his 16-year government career to come work for us. Unfortunately, we were unable to lure him away. Despite the fact that his government salary compares poorly with current local private sector equivalents, it still paid him twice as much as what the Embassy could offer. In fact, the previous incumbent in that position left the Embassy for a job that paid twice as much as he had earned at the Embassy.

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¶13. (SBU) Similarly, Post has struggled to attract qualified applicants for the Facilities Maintenance foreman position at the advertised salary. We had to lower the requirements of the position and re-advertise. In the end, post was unable to attract a qualified candidate from outside and hired from within. We found from an informal market analysis that the British Embassy pays their foreman 20% more than we do. (We expect that disparities similar to these will be recorded on the next comparator survey, which should be completed by Birches Group in July/August 2009.)

Next Steps on Embassy Salaries

¶14. (SBU) The large accumulated difference between Embassy salaries and average salaries in the economy will be exacerbated in 2009 as the price-salary spiral continues. In September 2008, HR/OE gave Post authorization to raise wages between 12.60% and 30.59%, depending on the grade of the position. To date, Post has been able to increase salaries by a cumulative 11% in FY09. Given the rate of inflation and the difficulties recruiting and retaining staff at this Mission, it is clear that we need to carry out another salary increase to remain competitive. Post intends to fully utilize the authorization granted and implement another salary increase as soon we receive confirmation of exchange rate gains from WHA/EX.

Comment: LES Hit by Stagflation

¶15. (SBU) Many analysts started this year expecting inflation to moderate on the back of lower global commodity prices and a contraction in domestic demand. However, the continuation of high domestic wage increases, a significant increase in utility and transportation prices due to cutbacks in GoA subsidies, still high fiscal spending ahead of June 28 mid-term legislative elections, and the steady depreciation of the peso have all combined to keep actual inflation well into double digits. In past cables, Post has argued that the decisive factors that would determine whether deflationary or inflationary forces won out would be wage increases and peso depreciation. So far in 2009, it looks like both will support higher consumer price increases and higher inflationary expectations in the medium term. This could worsen after the elections, assuming the consensus view is correct that the Argentine Central Bank will allow the peso to depreciate at a faster rate and end the year in the 4-4.20 pesos/dollar range (from the current level of 3.75). With negative growth expected this year and low growth expected in 2010, and inflation remaining stubbornly high, Argentina is likely facing several difficult years of stagflation amidst an environment of dangerous financial uncertainty and volatility.

¶16. (SBU) In this environment, it is essential for Post to have the flexibility to increase LES wages to a comparable level with those of the private sector. Otherwise, our employees' standards of living will continue to deteriorate and Post's ability to compete for top talent (still highly sought in the competitive Argentine labor market) will continue to diminish.

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